

CENTRAL WATER SYSTEM
INDEPENDENT AUDITORS' REPORTS
FINANCIAL STATEMENTS AND
SCHEDULE OF FINDINGS
DECEMBER 31, 2013 AND 2012

CENTRAL WATER SYSTEM

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CENTRAL WATER SYSTEM

DECEMBER 31, 2013

OFFICIALS

<u>NAME</u>	<u>TITLE</u>
Jake Hinshaw	Director - Chairman
Gary Vos	Director - Secretary/Treasurer
Russ Eckard	Director
Michael Miller	Plant Superintendent

INDEPENDENT AUDITORS' REPORT

Board of Directors
Central Water System
Okoboji, IA 51355

We have audited the accompanying statements of net position of Central Water System (System) as of December 31, 2013 and 2012, the related statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the System's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Qualified Opinion

As discussed in Note 6, the System did not record or disclose the net annual required contribution for other postemployment benefits (OPEB) or the net OPEB liability obligations as required by Government Accounting Standards Board Statement No. 45. The effect of the departure on the financial statements is not reasonably determinable.

Qualified Opinion

In our opinion, except for the effects of the matter described in the "Basis for Qualified Opinion" paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Central Water System at December 31, 2013 and 2012 and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

The System has not presented management's discussion and analysis which introduces the basic financial statements by presenting certain financial information as well as management's analytical insight on that information that the Government Accounting Standards Board has determined is necessary to supplement, although not required to be a part of, the basic financial statements.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2014 on our consideration of Central Water System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Central Water System's internal control over financial reporting and compliance.

Wintner, Starnes Co., LLP

June 24, 2014

BASIC FINANCIAL STATEMENTS

CENTRAL WATER SYSTEM
STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012

ASSETS

	<u>2013</u>	<u>2012</u>
CURRENTS ASSETS:		
Cash	\$ 163,968	\$ 251,819
Accounts receivable	14,904	155,960
Prepaid expenses	<u>5,985</u>	<u>25,342</u>
TOTAL CURRENT ASSETS	<u>184,857</u>	<u>433,121</u>
NONCURRENT ASSETS:		
Capital assets	15,855,446	15,804,392
Accumulated depreciation	<u>(2,254,733)</u>	<u>(1,870,222)</u>
CAPITAL ASSETS - NET	<u>13,600,713</u>	<u>13,934,170</u>
Restricted assets:		
Bond sinking fund	<u>7,438</u>	<u>7,658</u>
TOTAL RESTRICTED ASSETS	<u>7,438</u>	<u>7,658</u>
TOTAL NONCURRENT ASSETS	<u>13,608,151</u>	<u>13,941,828</u>
TOTAL ASSETS	<u>\$13,793,008</u>	<u>\$14,374,949</u>

CENTRAL WATER SYSTEM
STATEMENTS OF NET POSITION - Continued
DECEMBER 31, 2013 AND 2012

LIABILITIES AND NET POSITION

	<u>2013</u>	<u>2012</u>
CURRENT LIABILITIES:		
Accounts payable	\$ 12,671	\$ 579,329
Accrued interest	3,447	3,447
Accrued payroll taxes	4,392	4,254
Current portion long-term debt	<u>60,000</u>	<u>60,000</u>
TOTAL CURRENT LIABILITIES	<u>80,510</u>	<u>647,030</u>
NONCURRENT LIABILITIES:		
Revenue bonds payable	665,000	725,000
Less current portion above	<u>(60,000)</u>	<u>(60,000)</u>
TOTAL NONCURRENT LIABILITIES	<u>605,000</u>	<u>665,000</u>
TOTAL LIABILITIES	<u>685,510</u>	<u>1,312,030</u>
NET POSITION:		
Net investment in capital assets	12,935,713	13,200,912
Restricted for:		
Debt service	7,438	7,658
Unrestricted	<u>164,347</u>	<u>(145,651)</u>
TOTAL NET POSITION	<u>13,107,498</u>	<u>13,062,919</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$13,793,008</u>	<u>\$14,374,949</u>

CENTRAL WATER SYSTEM
STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
REVENUE:		
Operating income	\$ 305,794	\$ 355,395
OPERATING EXPENSES:		
Salaries - superintendent	53,865	51,708
Salaries - other	48,907	46,969
Chemicals	65,833	36,311
Repairs	8,352	2,931
Utilities	71,845	33,564
Payroll taxes and benefits	17,324	15,895
Employee insurance	29,153	27,672
General insurance	25,423	18,915
Lab supplies	1,176	5,388
Testing and lab fees	3,559	6,422
Vehicle expenses	975	1,013
Clothing allowance	791	767
Legal and professional	9,055	6,483
Office supplies and postage	1,670	954
Telephone	3,283	2,313
Board expense	1,600	1,450
Bond expense	500	500
Continuing education	410	350
Depreciation	470,700	153,990
Licenses and permits	211	91
Purchased water	2,253	27,345
TOTAL OPERATING EXPENSES	<u>816,885</u>	<u>441,031</u>
OPERATING LOSS	<u>(511,091)</u>	<u>(85,636)</u>
NON-OPERATING INCOME (EXPENSE):		
Interest income	289	618
Other income	29,397	18,857
Interest expense	(31,900)	(34,539)
Loss on disposed assets	(146,591)	(2,610)
TOTAL NON-OPERATING EXPENSE - NET	<u>(148,805)</u>	<u>(17,674)</u>
LOSS BEFORE CAPITAL CONTRIBUTIONS	(659,896)	(103,310)
CAPITAL CONTRIBUTIONS	<u>704,475</u>	<u>6,167,823</u>
CHANGE IN NET POSITION	44,579	6,064,513
NET POSITION - BEGINNING OF YEAR (AS RESTATED)	<u>13,062,919</u>	<u>6,998,406</u>
NET POSITION - END OF YEAR	<u>\$13,107,498</u>	<u>\$13,062,919</u>

CENTRAL WATER SYSTEM
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	\$ 304,586	\$ 365,895
Cash paid to suppliers	(218,854)	(206,608)
Cash paid to employees	<u>(102,772)</u>	<u>(98,677)</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>(17,040)</u>	<u>60,610</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Principal paid on bonds	(60,000)	(60,000)
Interest paid on bonds	(31,900)	(34,539)
Capital asset acquisitions	(855,556)	(6,359,244)
Other income	29,397	18,857
Capital contributions	<u>846,739</u>	<u>6,373,063</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(71,320)</u>	<u>(61,863)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income	<u>289</u>	<u>618</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>289</u>	<u>618</u>
NET CHANGE IN CASH	(88,071)	(635)
CASH - BEGINNING	<u>259,477</u>	<u>260,112</u>
CASH - ENDING	<u>\$ 171,406</u>	<u>\$ 259,477</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATIONS:		
Operating loss	\$ (511,091)	\$ (85,636)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	470,700	153,990
(Increase) decrease in:		
Accounts receivable	(1,208)	10,500
Prepaid expenses	19,357	(5,635)
Increase (decrease) in:		
Accounts payable	5,064	(12,707)
Accrued expenses	<u>138</u>	<u>98</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>\$ (17,040)</u>	<u>\$ 60,610</u>

CENTRAL WATER SYSTEM
STATEMENTS OF CASH FLOWS - Continued
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCING ACTIVITIES:		
Capital asset purchases	\$ 283,834	\$6,476,301
(Increase) decrease in construction accounts payable	<u>571,722</u>	<u>(117,057)</u>
Cash paid to purchase capital assets	<u>\$ 855,556</u>	<u>\$6,359,244</u>
Capital contributions from cities	\$ 704,475	\$6,167,823
Decrease in capital contributions included in accounts receivable	<u>142,264</u>	<u>205,240</u>
Cash received from cities for capital contributions	<u>\$ 846,739</u>	<u>\$6,373,063</u>
RECONCILIATION OF CASH TO THE STATEMENTS OF NET ASSETS:		
Cash	\$ 163,968	\$ 251,819
Bond Sinking Fund	<u>7,438</u>	<u>7,658</u>
Total Cash	<u>\$ 171,406</u>	<u>\$ 259,477</u>

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2013 AND 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Central Water System was organized by a Joint Public Improvement Agreement between the City of Arnolds Park and the City of Okoboji dated April 11, 1977. Central Water System, organized under the Code of Iowa, Chapter 28E, was designed to operate a water system to jointly serve the two municipalities. Iowa Lakes Regional Water was later added as a customer through a water purchase contract with Central Water System dated January 11, 1989. All facilities and land acquired or constructed in connection with the System are to be owned by the two municipal parties as tenants in common with undivided ownership interest, the common facilities to be referred to as "Central Water System".

Central Water System is a component unit of the City of Arnolds Park, Iowa, as determined by criteria specified by the Governmental Accounting Standards Board. The System is operated by the parties through a joint Board of Directors consisting of one member from each city council, or such other individual as that council shall designate, and a third member appointed and approved by a majority vote of the city councils of the municipalities.

The System's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board.

Reporting Entity

For financial reporting purposes, Central Water System has included all funds, organizations, account groups, agencies, boards, commissions, and authorities. The System has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the System are such that exclusion would cause the System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria included appointing a voting majority of an organization's governing body, and (1) the ability of the System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the System. Central Water System has no component units which meet the Governmental Accounting Standards Board criteria.

Basis of Presentation

The accounts of Central Water System are organized as an Enterprise Fund. Enterprise Funds are used to account for operations (a) financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Measurement Focus and Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The System distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the System's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating income and expenses.

Assets and Liabilities

The following accounting policies are followed in preparing the Statement of Net Position:

Cash - For the purposes of the statement of cash flows, the System considers as cash all currency on hand, demand deposits with banks or other financial institutions, certificates of deposit with an original maturity of three months or less, and other accounts that have the general characteristics of demand deposits in that the System may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty.

Accounts Receivable - Accounts receivable and revenue are recorded at the time that service is provided and billed. Unbilled revenue for service consumed between periodic scheduled billing dates is not considered to have a material effect on the financial statements. Accounts are reviewed annually; accounts considered uncollectible are written off at that time.

Capital Assets - Capital assets are accounted for at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. The cost of repair and maintenance is charged to expense, while the cost of renewals or substantial betterments is capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations.

Reportable capital assets are defined by the System as assets with initial, individual costs in excess of the following thresholds and estimated useful lives in excess of two years.

<u>Asset Class</u>	<u>Amount</u>
Plant and distribution system	\$ 25,000
Equipment and vehicles	\$ 5,000

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Capital assets of the System are depreciated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Lives (In Years)</u>
Plant and distribution system	10 - 40
Equipment and vehicles	5 - 15

Interest costs are capitalized when incurred on debt where proceeds were used to finance the construction of assets. Interest earned on proceeds of tax-exempt borrowing arrangements restricted to the acquisition of qualifying assets is offset against interest costs in determining the amount to be capitalized. The System had no capitalized interest during 2013 and 2012.

Restricted Assets - Funds set aside for payment of revenue bonds and notes are classified as restricted.

Compensated Absences - Central Water System has established a written policy for sick leave and vacation accrual which states that no sick leave or vacation pay will accumulate one year to the next. Therefore, there are no accrued compensated absences at December 31, 2013 and 2012.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Income Taxes - Central Water System is exempt from federal and state income taxes.

Subsequent Events - Management has evaluated subsequent events through the date of the independent auditors' report, which is the date the financial statements were available to be issued.

2. DEPOSITS AND INVESTMENTS

The System's deposits in banks at December 31, 2013 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

2. DEPOSITS AND INVESTMENTS - Continued

The System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Directors; prime eligible bankers acceptances; certain high-rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; and certain joint investment trusts.

The System had no investments meeting the disclosure requirements of Government Accounting Standards Board Statement No. 3, as amended by Statement No. 40.

3. CAPITAL ASSETS

A summary of capital assets at December 31, 2013 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Capital assets not being depreciated:				
Construction work in progress	\$ 9,897,455	\$ 701,332	\$(10,598,787)	\$ 0
Capital assets being depreciated:				
Plant and distribution system	5,896,333	8,735,213	(232,780)	14,398,766
Equipment	10,604			10,604
Project costs		1,446,076		1,446,076
Total capital assets being depreciated	<u>5,906,937</u>	<u>10,181,289</u>	<u>(232,780)</u>	<u>15,855,446</u>
Less accumulated depreciation for:				
Plant and distribution system	1,862,647	457,698	(86,189)	2,234,156
Equipment	7,575	981		8,556
Project costs		12,021		12,021
Total accumulated depreciation	<u>1,870,222</u>	<u>470,700</u>	<u>(86,189)</u>	<u>2,254,733</u>
Capital assets - net	<u>\$13,934,170</u>	<u>\$10,411,921</u>	<u>\$ 10,745,378</u>	<u>\$13,600,713</u>

A summary of capital assets at December 31, 2012 is as follows:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year
Capital assets not being depreciated:				
Construction work in progress	\$6,220,889	\$6,476,301	\$(2,799,735)	\$ 9,897,455
Capital assets being depreciated:				
Plant and distribution system	3,128,172	2,799,735	(31,574)	5,896,333
Equipment	73,489		(62,885)	10,604
Total capital assets being depreciated	<u>3,201,661</u>	<u>2,799,735</u>	<u>(94,459)</u>	<u>5,906,937</u>
Less accumulated depreciation for:				
Plant and distribution system	1,741,213	153,008	(31,574)	1,862,647
Equipment	66,868	982	(60,275)	7,575
Total accumulated depreciation	<u>1,808,081</u>	<u>153,990</u>	<u>(91,849)</u>	<u>1,870,222</u>
Capital assets - net	<u>\$7,614,469</u>	<u>\$9,122,046</u>	<u>\$(2,802,345)</u>	<u>\$13,934,170</u>

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

4. LONG-TERM DEBT

A summary of changes in long-term liabilities for the year ended December 31, 2013 is as follows:

	<u>Balance Beginning of Year</u>	<u>Decreases</u>	<u>Balance End of Year</u>	<u>Due Within One Year</u>
Revenue bond:				
Series 2007	<u>\$725,000</u>	<u>\$ 60,000</u>	<u>\$665,000</u>	<u>\$ 60,000</u>

A summary of changes in long-term liabilities for the year ended December 31, 2012 is as follows:

	<u>Balance Beginning of Year</u>	<u>Decreases</u>	<u>Balance End of Year</u>	<u>Due Within One Year</u>
Revenue bond:				
Series 2007	<u>\$785,000</u>	<u>\$ 60,000</u>	<u>\$725,000</u>	<u>\$ 60,000</u>

Series 2007 Notes - \$990,000 Water Revenue Refunding Capital Loan Notes, Series 2007 were issued during 2007. These notes bear interest at 4.40% per annum and mature in varying annual amounts ranging from \$50,000 to \$90,000, with final maturity due in the year ending December 31, 2022. See also Note 10.

The resolution providing for the issuance of the revenue notes includes the following provisions:

- (a) The notes will only be redeemed from the future earnings for the enterprise activity and the note holders hold a lien on the future earnings of the system.
- (b) Sufficient monthly transfers shall be made to a revenue note sinking fund account for the purpose of making the note principal and interest payments when due.
- (c) User rates shall be established at a level which produces net revenues at a level not less than 110% of the amount of principal and interest on the notes falling due in the same year. The System did not satisfy this requirement for the years ended December 31, 2013 and 2012.

A summary of the annual revenue bond principal and interest requirements to maturity at December 31, 2013 is as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 60,000	\$ 29,260	\$ 89,260
2015	65,000	26,620	91,620
2016	65,000	23,760	88,760
2017	70,000	20,900	90,900
2018	75,000	17,820	92,820
2019 - 2022	<u>330,000</u>	<u>36,960</u>	<u>366,960</u>
Total	<u>\$ 665,000</u>	<u>\$155,320</u>	<u>\$ 820,320</u>

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

5. PENSION AND RETIREMENT BENEFITS

The System contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, PO Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 5.38% of their annual salary through June 30, 2012 and 5.78% thereafter and the System is required to contribute 8.07% of annual covered payroll through June 30, 2012 and 8.67% thereafter. Contribution requirements are established by State statute. The System's contributions to IPERS for the years ended December 31, 2013, 2012, and 2011 were \$8,917, \$8,237, and \$7,246, respectively, equal to the required contributions for each year.

457 Deferred Compensation Plan

The System offers a deferred compensation plan created in accordance with Internal Revenue Code Section 457 to System employees. The plan permits the employees to defer a portion of current salary until future years. The System does not contribute to the plan. Plan funds are held in trust by a third party investor. The System provides neither administrative service to the plan nor investment advice for the plan.

6. OTHER POST EMPLOYMENT BENEFITS (OPEB)

The System operates a single-employer retiree benefit plan which provides medical/prescription drug benefits for retirees and their spouses. There are two active and no retired members in the plan. Participants must be age 55 or older and meet certain other requirements at retirement. Benefits terminate upon attaining Medicare eligibility. Coverage is provided through a fully-insured plan. Retirees under age 65 pay the same premium for the medical/prescription drug benefit as active employees, which results in an implicit subsidy. It is anticipated retiree premiums will be fully offset by monthly contributions.

The System has not implemented GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits other Than Pensions. This is a departure from accounting principles generally accepted in the United States of America. The amount by which this departure would affect liabilities, net position, and expenses is not reasonably determinable.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

7. RISK MANAGEMENT

The System is a member of the Iowa Communities Assurance Pool, as allowed by Chapter 670.7 of the Code of Iowa. The Iowa Communities Assurance Pool (Pool) is a local government risk-sharing pool whose 679 members include various governmental entities throughout the State of Iowa. The Pool was formed in August 1986 for the purpose of managing and funding third-party liability claims against its members. The Pool provides coverage and protection in the following categories: general liability, automobile liability, automobile physical damage, public officials liability, police professional liability, property, inland marine, and boiler/machinery. There have been no reductions in insurance coverage from prior years.

Each member's annual casualty contributions to the Pool fund current operations and provide capital. Annual operating contributions are those amounts necessary to fund, on a cash basis, the Pool's general and administrative expenses, claims, claims expenses, and reinsurance expenses due and payable in the current year, plus all or any portion of any deficiency in capital. Capital contributions are made during the first six years of membership and are maintained to equal 300 percent of the total current members' basis rates or to comply with the requirements of any applicable regulatory authority having jurisdiction over the Pool.

The Pool also provides property coverage. Members who elect such coverage make annual operating contributions which are necessary to fund, on a cash basis, the Pool's general and administrative expenses and reinsurance premiums, all of which are due and payable in the current year, plus all or any portion of any deficiency in capital. Any year-end operating surplus is transferred to capital. Deficiencies in operations are offset by transfers from capital and, if insufficient, by the subsequent year's member contributions.

The System's property and casualty contributions to the risk pool are recorded as disbursements from its operating funds at the time of payment to the risk pool. The System's annual contributions to the Pool for the years ended December 31, 2013 and 2012 were \$23,121 and \$16,670, respectively.

The Pool uses reinsurance and excess risk-sharing agreements to reduce its exposure to large losses. The Pool retains general, automobile, police professional, and public officials' liability risks up to \$350,000 per claim. Claims exceeding \$350,000 are reinsured in an amount not to exceed \$2,650,000 per claim. For members requiring specific coverage from \$3,000,000 to \$15,000,000, such excess coverage is also reinsured. Property and automobile physical damage risks are retained by the Pool up to \$250,000 each occurrence, each location, with excess coverage reinsured by the Lexington Insurance Company.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

7. RISK MANAGEMENT - Continued

The Pool's intergovernmental contract with its members provides that in the event a casualty claim or series of claims exceeds the amount of risk-sharing protection provided by the member's risk-sharing certificate, or in the event that a series of casualty claims exhausts total members' equity plus any reinsurance and any excess risk-sharing recoveries, then payment of such claims shall be the obligation of the respective individual member. The System does not report a liability for losses in excess of reinsurance or excess risk-sharing recoveries unless it is deemed probable such losses have occurred and the amount of such loss can be reasonably estimated. Accordingly, at December 31, 2013, no liability has been recorded in the System's financial statements. As of December 31, 2013, settled claims have not exceeded the risk pool or reinsurance company coverage since the pool's inception.

Members agree to continue membership in the Pool for a period of not less than one full year. After such period, a member who has given 60 days' prior written notice may withdraw from the Pool. Upon withdrawal, payments for all casualty claims and claims expenses become the sole responsibility of the withdrawing member, regardless of whether a claim was incurred or reported prior to the member's withdrawal. Members withdrawing within the first six years of membership may receive a partial refund of their casualty capital contributions. If a member withdraws after the sixth year, the member is refunded 100% of its capital contributions; however, the refund is reduced by an amount equal to the annual casualty operating contribution which the withdrawing member would have made for the one-year period following withdrawal.

The System also carries commercial insurance purchased from other insurers for coverage associated with workers' compensation. The System assumes liability for any deductibles and claims in excess of coverage limitations. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

8. MAJOR CUSTOMERS

During the years ended December 31, 2013 and 2012, the System received 98% of its revenues from two entities as follows:

	2013		2012	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
City of Arnolds Park	\$161,301	53%	\$184,437	52%
City of Okoboji	\$137,280	45%	\$163,758	46%

9. LITIGATION

The System may become party to routine legal proceedings and litigation arising in the normal course of governmental operations. These legal proceedings typically are not expected to have a material adverse impact on the System's financial condition.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - Continued
YEARS ENDED DECEMBER 31, 2013 AND 2012

10. SUBSEQUENT EVENTS

On June 1, 2014, the two cities contributed capital to be used to redeem the outstanding bonds.

11. CHANGE IN ACCOUNTING PRINCIPLE - RETROSPECTIVE APPLICATION

Effective January 1, 2012, the System retroactively changed its method of accounting for certain debt issuance costs as an implementation of the provisions of Government Accounting Standards Board (GASB) Statement 62, which requires the System expense debt issuance costs, except any portion related to prepaid insurance costs, in the period incurred.

The Organization has recorded a cumulative-effect adjustment to opening assets and unrestricted net position effective January 1, 2012. In addition, the financial statements as of and for the year ended December 31, 2012 have been restated to reflect the effect of the change. Details of the effect of the change to the December 31, 2012 Statement of Net Position are provided below.

	As Originally <u>Reported</u>	Effect of <u>Change</u>	As <u>Adjusted</u>
Bond and note issuance costs	\$ 8,258	\$ (8,258)	\$ 0
Issuance costs of refunded bonds	16,905	(16,905)	0
Net position	13,088,082	(25,163)	13,062,919

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors
Central Water System
Okoboji, IA 51355

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States the financial statements of Central Water System as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the basic financial statements of Central Water System, and have issued our report thereon dated June 24, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Central Water System's internal control over financial reporting (internal control) to determine the audit procedures appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control such that there is a reasonable possibility a material misstatement of the System's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control described in Part I of the accompanying Schedule of Findings as item I-A-13 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Central Water System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. However we noted certain immaterial instances of noncompliance or other matters that are described in Part II of the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about Central Water System's operations for the year ended December 31, 2013 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of Central Water System. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

Central Water System's Responses to Findings

The System's responses to findings identified in our audit are described in the accompanying Schedule of Findings. The System's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing and not to provide an opinion on the effectiveness of Central Water System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Central Water System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Central Water System during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Wenther, Starn & Co., LLP

June 24, 2014

CENTRAL WATER SYSTEM
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2013

Part I: Findings Related to the Financial Statements

Internal Control Deficiencies:

I-A-13 Segregation of Duties - During our review of internal control, existing procedures were evaluated in order to determine whether incompatible duties, from a control standpoint, are performed by the same employee. We noted that one individual is primarily responsible for all recordkeeping and reconciling functions for the System.

Recommendation - We realize with a limited number of office employees, segregation of duties is difficult. However, the System should review the operating procedures of the office to obtain the maximum internal control possible under the circumstances with continued administrative review by Directors.

Response - We continually review our operating procedures and strive to improve internal control and segregation of duties whenever possible. Administrative and Board review of transactions and financial information is an important part of the controls in place, and is relied upon to strengthen controls.

Conclusion - Response accepted.

Instances of Noncompliance:

No matters were noted.

CENTRAL WATER SYSTEM
SCHEDULE OF FINDINGS - Continued
FOR THE YEAR ENDED DECEMBER 31, 2013

Part II: Other Findings Related to Statutory Reporting

II-A-13 Questionable Expenses - We noted no expenses that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-B-13 Travel Expense - No expenditures of money for travel expenses of spouses of System officials or employees were noted.

II-C-13 Board Minutes - No transactions were found that we believe should have been approved in the System's minutes but were not.

II-D-13 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa were noted.

II-E-13 Revenue Bonds - The System has not complied with water revenue bond resolutions. The System has not maintained user rates at a level sufficient to produce net revenues to the extent required by the respective bond resolutions.

Recommendation - The System should determine whether existing water user rates will be sufficient to produce the required net revenues or whether user rates should be increased.

Response - We will examine existing water user rates to determine the level required to comply with bond resolution net revenue requirements.

Conclusion - Response accepted.